AdvaMed Responses to
Manufacturing Working Group: Questions on Tax Reform
U.S. House Committee on Ways and Means

AdvaMed believes that tax reform should support job creation, economic growth and competitiveness. To achieve these objectives, tax reform should:

- **Provide a level playing field for medical device companies competing in world markets.**
- **Encourage retention and expansion of jobs in the U.S. by providing tax incentives comparable to or better than our major competitor nations.**
- **Provide incentives for investment in research and development, which is key to the growth of the knowledge-based, high value-added industries on which America's economic future depends**
- **Encourage the availability of capital for small and start-up companies that play a vital role in inventing and developing innovative breakthrough products.**
- **Eliminate the medical device tax.**

Manufacturing Tax Incentives: A Tax Code to Increase U.S. Manufacturing

From the perspective of your industry/company, which provisions in the current Tax Code do you consider the most important to manufacturers?

With regard to provisions of the current tax code, although medical technology companies benefit from many provisions of the code:

- The two most valuable tax provisions affecting both U.S. companies and U.S. subsidiaries of foreign companies are the deduction for income attributable to domestic production activities and the R&D credit.
- The most significant tax provision for most U.S. domiciled companies is deferral of active income of foreign-owned subsidiaries.

There is consensus among our membership that the current U.S. tax system is uncompetitive and needs reform. Key elements of reform include:

- repealing the medical device tax;
- moving towards a competitive international ("territorial") tax system to reduce the current disincentive to invest foreign earnings in U.S. operations;
- lowering the combined Federal and state corporate tax rate to levels comparable to or lower than competitor nations;
- making the R&D credit permanent and providing research and development incentives comparable to or better than competitor nations;
- establishing an "innovation box" regime that provides a substantially reduced corporate tax rate for profits derived from intellectual property developed in the U.S. or used in manufacturing products in the U.S.;

- providing additional incentives to invest in start-up, pre-profit companies.

A prerequisite for making the code more competitive for our industry is elimination of the medical device excise tax included in the affordable care act, which increased the industry's overall federal tax burden by 29%, according to an analysis by Ernst and Young.

Of these tax provisions, in the context of comprehensive tax reform, which of these would you be willing to give up in return for a lower tax rate?

Due to the diversity of the industry, AdvaMed cannot make that determination, but individual companies can provide guidance to the Committee.

While helpful and very important, a general reduction in the statutory corporate tax rate is not enough to make the U.S. tax system competitive for our industry. As described in our response to the next question, medical technology companies pay an average effective rate of 31% on activities taxed in the U.S. and 14% on those taxed abroad. Lowering the statutory rate to 28% or even 25% would still leave a wide gap in U.S. competitiveness. To make the U.S. tax system truly competitive for knowledge-based, high value added manufacturing industries like ours, a lower overall tax rate should be coupled with more targeted incentives comparable to those provided by foreign governments eager to attract or develop these industries.

In addition to addressing the issue of an uncompetitive tax rate, a reformed tax system should provide incentives to invest in pre-revenue and pre-profitability firms, which will not benefit from a lower tax rate on profits. Such start-up firms account for a disproportionate share of the growth-fueling innovation in our industry but have had a very difficult time raising capital in recent years. Foreign countries are aggressively encouraging investment in such firms.

The U.S. Corporate Rate, Manufacturing Tax Incentives, and the Global Landscape
Are the tax incentives available to U.S. manufacturers similar to the tax incentives available to your international competitors? If not, please provide examples.

The U.S corporate tax code is highly uncompetitive for our industry and acts as a significant disincentive for locating manufacturing and other activities in the United States. Based on a survey of our membership, the average effective corporate income tax rate paid for activities taxed in the United States was 31%, more than twice as high as 14% average rate paid for activities taxed abroad. The rate in some foreign jurisdictions is significantly lower than 14%. When the effect of the device tax and state and local income taxes are considered, the average U.S. tax rate rises to more than 40%. In the same survey, we asked the question: "Based on your own company's experience, does a more favorable tax system or direct subsidies provided by foreign governments play a role in the decision to locate manufacturing activities abroad rather than in the U.S." Sixty-three percent of respondents said that the more favorable tax system provided by foreign governments played a major role and the remainder of the respondents said it played some role.

A competitive tax system for the U.S. must include the following pro-competitive features typically offered by competitor nations:

- a competitive international tax system
- a lower statutory rate
- greater and permanent tax benefits for R&D
- patent or innovation box regimes that reduce rates for income based on intellectual property
- incentives for domestic manufacture
- incentives for capital investment in start-up companies

It should also be noted that a number of competitor nations provide special tax concessions or other subsidies for individual projects. In our nation, where such targeted subsidies would generally be inappropriate at the federal level, it is important to provide general and consistent rules that encourage location of R&D and manufacturing in the U.S.

In general, what impediments are there in the U.S. Tax Code that makes it difficult for American manufacturers to compete in a global marketplace?

As noted above, the U.S. tax system lacks key attributes that would help make companies competitive in today's global economy. Other nations, by contrast, work to provide the right incentives to attract and expand knowledge-based, high value added manufacturing industries like medical technology. These include a competitive international tax system to encourage the investment of profits earned abroad in the U.S., a lower statutory and effective tax rate, more generous tax incentives for R&D, special provisions to provide an attractive tax rate for manufacturing or other profits based on intellectual property, and incentives for domestic manufacturing. These defects put America at a serious competitive disadvantage and discourage investment in U.S. manufacturing by both American and foreign companies.

Are companies at a competitive disadvantage due to the fact that the US currently has the highest statutory corporate tax rate of all OECD countries?

Yes.

Would eliminating the tax expenditures listed in #1 and replacing such expenditures with a meaningful reduction in the statutory corporate tax rate help manufacturers to better compete domestically and/or internationally? What about for pass-through entities and smaller manufacturers if the individual marginal rate is reduced?

AdvaMed believes this question is best answered by individual companies. As noted in earlier answers, reducing the overall corporate tax rate would be very helpful, but would not by itself be sufficient to make the U.S. tax system adequately competitive for our industry. Targeted provisions directed at knowledge-based, high value manufacturing industries comparable to those offered by other countries are necessary, as are special provisions to encourage investment in pre-profitability small and start-up companies that will not benefit from a reduced tax rate on earnings.

Improving the Tax Code for Manufacturers: Reforming Manufacturing Tax Incentives.

Should any of the manufacturing tax provisions be modified to ease the administrative burden of compliance such as R&D? If so, how should such provisions be modified?

There is general consensus among our members that the R&D tax credit should be permanent and enhanced so that its value will to be more consistent with competitor nations. Members also find claiming the credit cumbersome, often involving lengthy disputes with the IRS.

Can you discuss how your company relies on or takes advantage of certain cost recovery provisions in the tax code, such as accelerated depreciation? How do those recovery methods help manufacturers manufacture cash flows? Do you think there are areas in the rules governing depreciation that should be evaluated or modified in tax reform?

This question can best be answered by individual companies.

How can the Tax Code better encourage manufacturers to innovate and develop new products here in the U.S.?

As noted above, AdvaMed believes that the U.S. tax code should create a level playing field with foreign governments. Key steps that are needed include:

- repealing the medical device tax
- moving towards a competitive international tax system
- lowering the combined Federal and state corporate tax rate to levels comparable to or lower than competitor nations;
- providing special incentives to establish a level-playing field that encourages the manufacturing technology-intensive, high value added products in the United States, including:
    - an enhanced R&D credit
    - a well-constructed "innovation box" regime; and
- incentives to encourage investment in start-up, pre-profit companies.

Many of our global competitors utilize patent boxes or "innovation boxes" which essentially provide tax benefits for the commercialization of successful R&D. Do you believe implementing such a structure in the US would help manufacturers compete globally?

If an innovation box is properly constructed, it has the potential to play an important role in encouraging medical technology manufacturers to locate activities in the U.S. and compete globally.